



NNSA
Business Management Advisory Council
White Paper
Extrapolation of Audit Findings
in Travel and Accounts Payable

□ Background – Hackett study/working groups

Several working groups were created as spin-offs of the NNSA sponsored Hackett benchmarking study, Travel among them, which were chartered to investigate the differences in statistics between the sites, normalize the data if necessary, and determine whether there were areas of opportunity for cost savings and/or efficiencies. The Travel working group rapidly determined that the information available from the Hackett benchmarking study was a good starting point but that more information was necessary. They sent out a survey to all the NNSA integrated contractors to gather more detailed information. After analyzing the results of the survey, they concluded there were 3 opportunities. The recommendations of the working group were:

- Each site to establish a risk based claim processing methodology based on the types and factors of travel which present higher risk and determine the percent of trips by type/factor which require audit by the Travel Office.
- Work to establish a common travel policy/guidelines across the NNSA complex
- Propose to NNSA to emulate corporate America in that a certain low level of errors are the “cost of doing business”, do not represent a significant risk to DOE and that an acceptable threshold for errors based on risk be approved by NNSA in order to reduce the cost of auditing 100% of the travel claims. Please note that in many cases the cost of auditing 100% of the travel claims exceeds the cost of the errors.

The last recommendation is the subject of this paper.

□ Risk Averse/consequences drive behavior

The government (DOE) is generally risk averse and that attitude is transferred to the M&O contractors that operate the various sites on behalf of DOE. Consequences drive behavior and when the





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consequence is unallowable cost, the behavior is to take whatever steps are necessary to reduce or eliminate the unallowable cost. Those steps are usually to increase staff in order to provide a greater level of review so as to eliminate completely any audit findings. This solution obviously increases the cost of operations.

❑ Cost of doing business/comparison to commercial practices

○ Data

There is a “cost of doing business” associated with the operation of any facility, whether it be a government laboratory or production facility or a commercial/private enterprise. Government requirements tend to make that cost greater than private industry; however, it should be a goal within government to drive the cost of operations down closer to commercial standards. Commercial enterprises acknowledge that there is a cost associated with perfection and the closer one gets to perfection, the higher the cost. The law of diminishing returns says that there is a point at which it costs more to attempt perfection than the actual cost of not being perfect. However, when the cost to achieve perfection is allowable and the cost of not being perfect is unallowable, one would always strive for perfection.

Hackett does not collect data on audits exactly; however, they do collect data on rework and they show World Class rework in Travel is 2% or less and Accounts Payable invoice corrections at 2% or less. That is a good indication that an error rate of 2% is considered acceptable in the commercial world.

❑ DOE Accounting Handbook – not necessary to be perfect

Chapter 11 of the DOE Accounting Handbook (DOE Order 534.1) states “A balance should be maintained between the effort required to measure accrued costs precisely and the added value of such precision”. Although this clause is talking about accrued cost, the same principal should be applied to all aspects of accounting.





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□ **Recent audit report**

A recent audit report at Los Alamos (FY09 Allowable Cost Audit) examined over \$2 billion costs, primarily using statistical methods. From their samples they found no questioned cost in Payroll, one incident of questioned cost in Travel (\$830), and two incidents of questioned cost in Accounts Payable (\$374) for a total questioned cost from the statistical sampling of \$1,204. The respective error rates were 0% for Payroll, .007% for Travel and 0.55% for Accounts Payable. This is a fantastic audit report. The summary stated that the auditors had not found any areas of internal control concern – that the internal controls in place were adequate.

However, the extrapolation called for the payment to DOE of \$227,367. How can something like this not drive bad behavior?

□ **Audit attitude**

Audit departments are required by audit guidelines **[insert correct reference]** to extrapolate. And when error rates are such that systemic problems or weak internal controls are evident, extrapolation is appropriate. However, we can see in corporate America that there is an acceptable level of error rate below which it is a good news story that validates the internal controls rather than being treated as a bad news story and requiring additional internal controls.

□ **Recommendation**

The NNSA should set an acceptable error rate similar to that in the commercial world and provide guidance to all auditors examining the NNSA integrated contractors that errors below that rate should be refunded to the government at actual cost and not at the extrapolated amounts. We suggest that 2% may achieve the right balance between the cost of doing business and the cost of perfection.

